



O C T O B E R 2 0 2 5

SPOTLIGHT ON:

IR35 and off-payroll working

A woman with long dark hair, wearing a striped t-shirt and denim overalls, is sitting on a white office chair. She is smiling and resting her head on her hand. The background shows a home office with a desk, a computer monitor, and some framed pictures on the wall.

A SMALL BUSINESS GUIDE TO IR35

Many small businesses rely on specialist contractors for flexibility and skills. That remains a sound approach, but the tax position needs care. The UK's IR35 and off-payroll working rules govern when a contractor should be taxed like an employee. Getting this right protects cashflow, avoids interest and penalties, and builds confidence with contractors and agencies.

This guide explains, in plain terms, how the rules apply in the 2025/26 tax year, what changed in April 2025, when those changes actually bite and how to set up simple, durable processes. It's written for owner-managers and finance teams who want a practical reference they can use throughout the year.

WHAT IR35 AND OFF-PAYROLL WORKING COVER

“IR35” is a shorthand for rules that ensure people who work like employees but through an intermediary (most commonly a personal service company (PSC)) pay broadly the same income tax and national insurance contributions (NICs) as employees. HMRC’s overview sets the scope and purpose of the rule.



There are two key frameworks.

- **Chapter 8 (ITEPA 2003):** often referred to as IR35, in this case the PSC is responsible for deciding status and paying any deemed employment taxes.
- **Chapter 10 (ITEPA 2003):** the off-payroll working rules mean the client (end-hirer) decides status and, if the engagement is “inside IR35”, the deemed employer in the supply chain runs PAYE.

Which framework applies depends mainly on your size (if you’re a private-sector client) and whether you are a public authority.

WHO DECIDES EMPLOYMENT STATUS IN 2025/26

- **Public sector clients:** you must determine status and operate PAYE for “inside IR35” engagements.
- **Medium and large private/voluntary sector clients:** you must determine status and operate PAYE where required.
- **Small private/voluntary sector clients:** you are exempt from Chapter 10. The contractor’s intermediary (such as a PSC) decides status under Chapter 8. You must confirm your size if asked by the worker or the agency.

Where Chapter 10 applies, you must issue a status determination statement (SDS) to the worker and the next party in the chain, explaining the outcome and your reasons. You must also keep records and have a process to handle disagreements.

WHAT COUNTS AS “SMALL” – AND WHAT’S CHANGING

SMALL COMPANY TEST USED FOR OFF-PAYROLL WORKING IN 2025/26

For the 2025/26 tax year, private companies are generally small for off-payroll purposes if they do not meet two or more of these conditions in the last relevant financial year:

- turnover more than £10.2m
- balance sheet total more than £5.1m
- more than 50 employees.

Where a simplified test applies to certain unincorporated clients, meeting a £10.2m annual turnover threshold brings you into scope. Group rules also apply: if the parent is medium/large, subsidiaries follow suit.

Important: The thresholds above are the ones that matter for off-payroll working assessments in 2025/26. See below for changes from 6 April 2025 and why they do not usually change your off-payroll position until 2027/28 at the earliest.

THRESHOLD INCREASES FROM FINANCIAL YEARS BEGINNING ON OR AFTER 6 APRIL 2025 – TIMING FOR OFF-PAYROLL

From financial years beginning on or after 6 April 2025, two of the Companies Act thresholds increase to: turnover £15m and balance sheet total £7.5m (employee limit remains 50). However, HMRC has confirmed how these increases flow through to the off-payroll rules using the last filed financial year and a two-year test.

The upshot is that, for most clients, the earliest off-payroll impact is the 2027/28 tax year (and often later).

Why the delay? The off-payroll regime looks at the last financial year for which the filing period ended before the start of the tax year, and a company generally needs to meet the size test for two consecutive financial years. HMRC’s manual includes transitional rules and examples that lead to 2027/28 as the earliest practical effect.

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WHAT THE LATEST HMRC DATA SAYS

HMRC's February 2025 update on the private-sector reforms (introduced 2021) estimates:

- around 120,000 workers were directly affected by the April 2021 reform
- about 45,000 fewer new PSCs formed around the time of the reform (vs trend, to March 2022)
- the reform generated about £4.2bn in additional tax, NICs and apprenticeship levy by March 2023
- those affected represent around 1% of the workforce (impacts vary by sector).

These figures help with resourcing decisions and what to expect if you change approach (for example, moving some roles onto payroll or re-scoping work to be genuinely outside IR35).

IF YOU ARE SMALL IN 2025/26: YOUR OBLIGATIONS AND GOOD PRACTICE

If you are small (outside the public sector), Chapter 10 does not apply to you in 2025/26. The contractor's intermediary decides status and accounts for tax/NICs under Chapter 8 (the "original IR35").

You should still:

- confirm your size when asked by the contractor or agency. HMRC guidance for intermediaries explains the worker can request confirmation and the client must respond within 45 days. Keep a simple template reply ready.
- clarify working practices in contracts and onboarding packs (substitution, control, equipment, financial risk, integration into teams and so on).
- keep records: request and file the contractor's company details, insurance certificates and engagement letter.
- re-check if your size will change in future years (see section 3.2). If you later become medium/large for off-payroll, you must switch to Chapter 10 from the relevant tax year.

Tip: If an agency or client in the chain asks for an SDS when you are small, explain that Chapter 10 doesn't apply to you in 2025/26 and provide written confirmation of small status for the tax year in question.



IF YOU ARE MEDIUM/ LARGE IN 2025/26: THE CORE STEPS

Where Chapter 10 applies, put these steps on a checklist.

1. Assess status for every engagement involving a PSC or other intermediary (contract-by-contract, based on actual working practices). You can use HMRC's check employment status for tax (CEST) tool to assist.
2. Take reasonable care in your determination (gather facts from hiring managers, review contracts, consider substitution and control, and document the rationale).
3. Issue an SDS stating (a) the conclusion and (b) your reasons. Send it to the worker and the party you contract with before payment. Maintain version control.
4. Identify the deemed employer (fee-payer) in your supply chain (often the party that pays the PSC). Ensure the SDS reaches the qualifying person in the chain; until it does, you risk being treated as the deemed employer.
5. Operate PAYE for inside IR35 roles: deduct income tax and employee NICs, pay employer NICs and (if applicable) apprenticeship levy. Keep Real Time Information (RTI) flagged correctly for off-payroll payments.
6. Run a client-led disagreement process (CLDP). Respond within 45 days when a worker or the deemed employer challenges the outcome. If you fail to respond in time, the tax/ NIC liability shifts to you.
7. Retain evidence: working-practice questionnaires, meeting notes, CEST outputs (PDF), SDS copies and any independent reviews.



Supply-chain risk: If the fee-payer fails to account for PAYE, HMRC can use transfer-of-debt rules to pursue another relevant party up the chain (for example, the end client), so due diligence on agencies matters.

USING CEST (AND WHAT'S CHANGED IN 2025)

HMRC updated CEST and related guidance on 30 April 2025. HMRC states it will stand by determinations the tool gives, provided the information entered is accurate and you follow HMRC guidance. You still need to keep evidence and revisit if the working practices change.

Independent reviews can be valuable where CEST returns “unable to determine” or where roles are borderline. If you use external tools or advisers, keep a clear audit trail showing how you reached the decision and that you took reasonable care.

PASSING THE SDS DOWN THE CHAIN (AND WHEN YOU REMAIN LIABLE)

While the legislation focuses on you issuing the SDS to the worker and your counterparty, HMRC guidance explains you remain the deemed employer until the SDS is passed down the labour supply chain to the next qualifying person. Build this hand-off into your accounts-payable workflow so no invoices get paid before the correct party has the SDS.

CONTRACTED-OUT SERVICES AND OVERSEAS CLIENTS

- **Contracted-out services:** where you buy an outsourced service (rather than labour) from a supplier, that supplier assesses and, if necessary, operates off-payroll. Take care to ensure a staff-augmentation agreement is not simply relabelled as a deliverables-based contract to sidestep the rules.
- **Overseas clients:** if the client has no UK connection (for example, wholly overseas with no UK permanent establishment), Chapter 10 does not apply and the PSC decides status.

THE 2024 SET-OFF CHANGE (DOUBLE-TAXATION MITIGATION)

From 6 April 2024, HMRC can offset certain taxes already paid by the worker or their PSC against the PAYE/NICs bill assessed on the deemed employer for past non-compliance. The mechanism applies to deemed direct payments made on or after 6 April 2017 (public sector) and 6 April 2021 (private sector), where the trigger event (such as settlement) is on or after 6 April 2024. This reduces the risk of double-collecting taxes across the chain.

Set-off does not erase interest or potential penalties for failures, and you still need robust processes to prevent errors in the first place.

QUICK REFERENCE: SMALL VS MEDIUM/LARGE

Topic	Small private-sector client (Chapter 8 applies)	Medium/large private-sector client (Chapter 10 applies)
Who decides status?	Contractor's intermediary (such as PSC).	Client (you) decides for each engagement.
SDS required?	Not required under Chapter 10. Provide size confirmation on request.	Yes. Must include decision and reasons, and be shared with worker and your counterparty.
PAYE/NICs operated by	PSC (if "inside" under Chapter 8).	Deemed employer in the chain (you or the fee-payer).
Disagreement process	Not applicable under Chapter 10.	Client-led dispute process; respond within 45 days.
Records	Keep contractor due-diligence and engagement terms.	Keep assessments, SDS, CEST outputs and correspondence.



PLANNING FOR THE THRESHOLD CHANGES (NOW THROUGH TO 2027)

1. Check your actual size for 2025/26 using the £10.2m/£5.1m/50 criteria. If you are medium/large, continue to apply Chapter 10.
2. For financial years beginning on or after 6 April 2025, monitor whether the new thresholds (£15m/£7.5m/50) change your size. Because of the two-year test and filing-date rule, the earliest off-payroll impact is tax year 2027/28 for most. Keep this on your risk register and revisit annually.
3. If you expect to fall outside Chapter 10 in a future year, plan your communications to agencies and contractors and update your onboarding packs to reflect the return to Chapter 8 responsibilities at the appropriate time.

FAQS

DOES AN “OUTSIDE IR35” SDS AFFECT EMPLOYMENT RIGHTS?

No. The SDS concerns tax only. Employment law tests may give a different result for rights (holiday pay and so on). Keep tax and employment law analyses separate.

IS CEST MANDATORY?

No, but HMRC will stand by CEST determinations if you used it correctly and the facts are accurate. You can use other tools or advisers; just ensure you take reasonable care and keep records.

WHAT IF WE BUY A DELIVERABLES-BASED PROJECT FROM A SUPPLIER?

If it is a genuine outsourced service, the supplier assesses and accounts for off-payroll where needed. Guard against contracts that are essentially staff supply relabelled as outsourcing.

WE'RE PART OF A GROUP – WHICH SIZE TEST APPLIES?

Group rules can pull you into scope if the parent is medium/large (figures aggregated).

IF HMRC LATER SAYS OUR “OUTSIDE” SDS WAS WRONG, WILL WE PAY TWICE BECAUSE THE PSC ALSO PAID TAX?

From 6 April 2024, HMRC can set off certain taxes already paid by the worker/ PSC against the deemed employer's assessed liabilities, reducing double taxation. Interest and penalties can still apply.

CONCLUSION

You can keep contractor hiring simple and compliant by focusing on three things: know whether Chapter 10 applies to you this tax year, make status decisions you can evidence, and embed SDS and payment controls in your workflow. For many small businesses, the off-payroll rules do not apply in 2025/26, but you still need clear documentation and a quick way to confirm your size when asked. For medium and large organisations, a short, well-run process beats ad hoc decisions every time.

If you'd like a light review of your current process, or a one-page policy and checklist tailored to your roles and supply chains, we can help you put that in place and reduce the admin burden.



Get in touch if you'd like tailored support in reviewing your contractor processes or setting up a clear off-payroll policy.

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